

# Insights into UniSuper's Investment Strategies

3 November 2006

David St. John (*Chief Investment Officer*)  
David Schneider (*Manager, Research and Risk Management*)  
Paul Laband (*Head of Public Markets*)  
Nick Stephens (*Manager, Property*)

## Agenda

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- › Fund Performance and Outlook
- › Key Strategies and Projects
- › The Pitfalls of Hedge Funds
- › Long/Short Investment Strategies
- › Recent Direct Property Transactions

## Our Fund



- › Over \$20B FUM
- › \$1.45B of income (\$850M member contributions + \$600M investment income)
- › 115 managers and products
- › 13 regular advisors
- › Projected to grow to \$50B in 10 years, \$130B in 20 years
- › 20 investment staff
- › UniSuper's investment arrangements continue to evolve with the Fund's growth

→ **Our focus continues to be on generating competitive, risk adjusted investment returns**



## Economic Overview

## Economic Overview



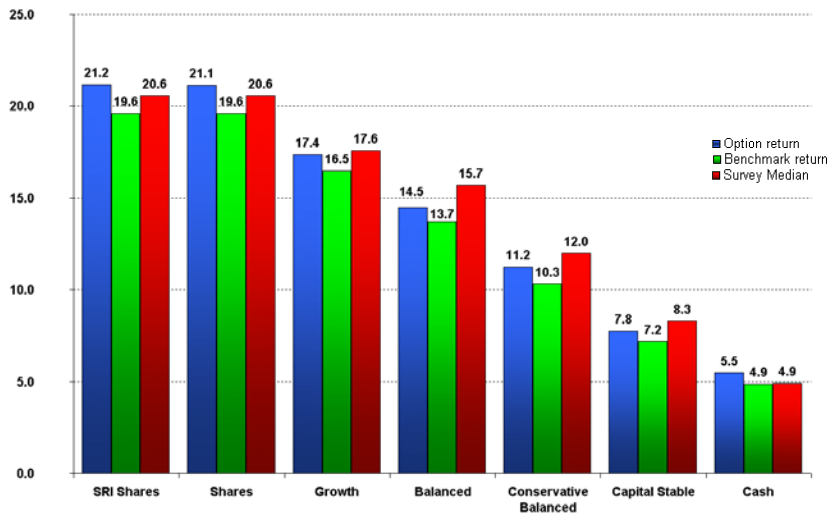
- › Key factors over the past year
  - Strong global growth, encouraged by China and the US
  - Surging commodity prices
  - Company earnings remain strong
  - Rising interest rates (Australia & US)
  
- › Asset returns have been favourable
  - International and Australian shares achieved strong returns
  - Strong commercial property returns
  - Fixed interest returns subdued



## Performance to 30 June 2006

## Option Returns

### Financial Year Ending 2006 (After Tax & Fees)

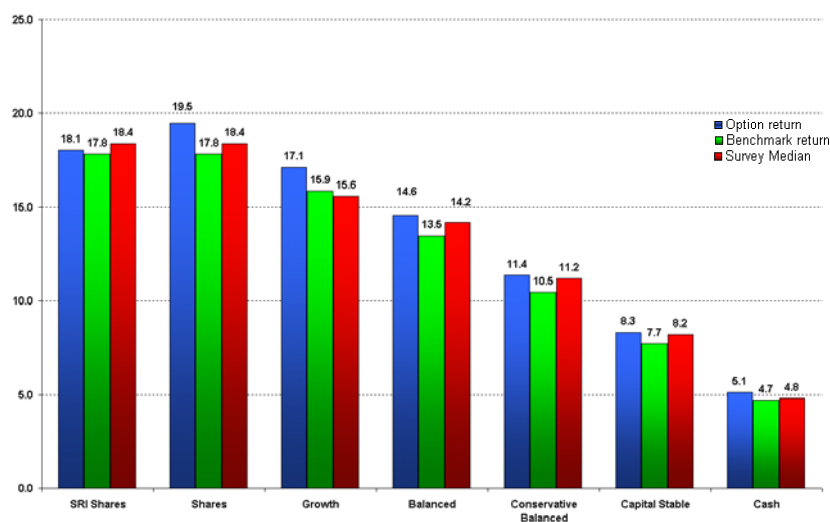


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## Option Returns

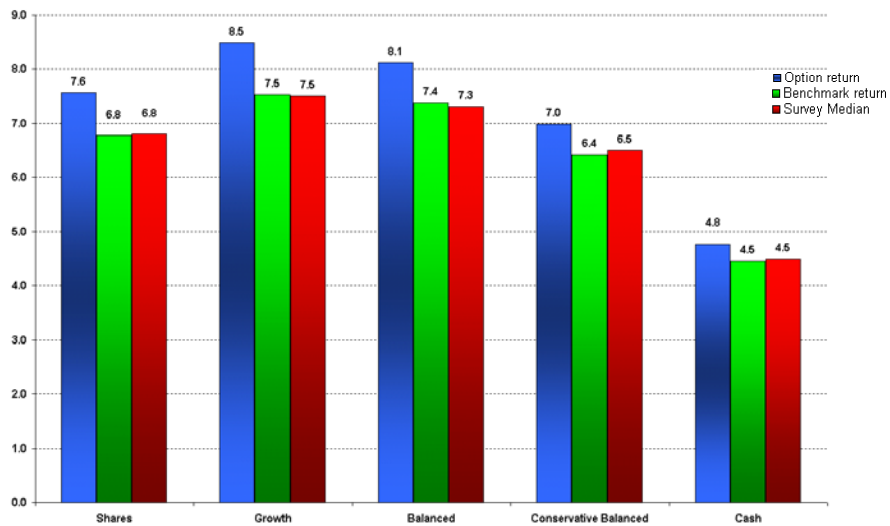
### 3 years (p.a.) to 30 June 2006 (After Tax & Fees)



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## Option Returns 5 years (p.a) to 30 June 2006 (After Tax & Fees)



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## Sources of Value Add



### › Three year Asset Class Attribution – 30 June 2006

Asset Class	Balanced Option Value Added (%p.a.)
Australian Shares	0.2
International Shares	0.8*
Property	0.1
Alternative Investments	0.0
Fixed Interest	0.0
Inflation Linked Bonds	0.0
<b>TOTAL</b>	<b>1.1</b>

\* Including emerging market and currency tilts

➔ **Diversified sources of value add**

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## Risk Return Profile



› ChantWest Survey – 5 years to 30 June 2006

Strategy	Fund	Return (% p.a.)	Standard Deviation (% p.a.)	Sharpe Ratio	Allocation to Growth Assets (% p.a.)
Growth	UniSuper	<b>8.5 (6/22)</b>	<b>5.1 (4/22)*</b>	<b>1.7 (5/22)</b>	85
	ChantWest Median	7.4	6.9	1.1	86
Balanced	UniSuper	<b>8.1 (7/31)</b>	<b>5.2 (7/31)*</b>	<b>1.6 (7/31)</b>	70
	ChantWest Median	7.3	5.7	1.3	74

\* 3 year standard deviation used as a proxy

→ UniSuper is doing well in risk adjusted terms

## CEM Benchmarking Survey



- › Compares UniSuper's costs and returns to Australian and international peer organisations
- › UniSuper achieved top quartile value add
- › UniSuper's costs were competitive

→ UniSuper is competitive on a global basis

# Economic Outlook

## Economic Outlook

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### › Next 12 months

- Slower global growth, but not a recession
- Inflation fears fading (Australian and US interest rates peaking?)
- Solid, but volatile returns from shares
- Commercial property is attractive
- Bonds offer modest returns (but ongoing diversification benefits)

### › Longer Term

- Relatively low return world (e.g. Balanced Option = 7.8% p.a. ATAF)

## Economic Risks

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- › Rising inflation & interest rates
- › Geopolitics (terrorism, North Korea)
- › China & resources bubble burst

## Broad Strategic Initiatives

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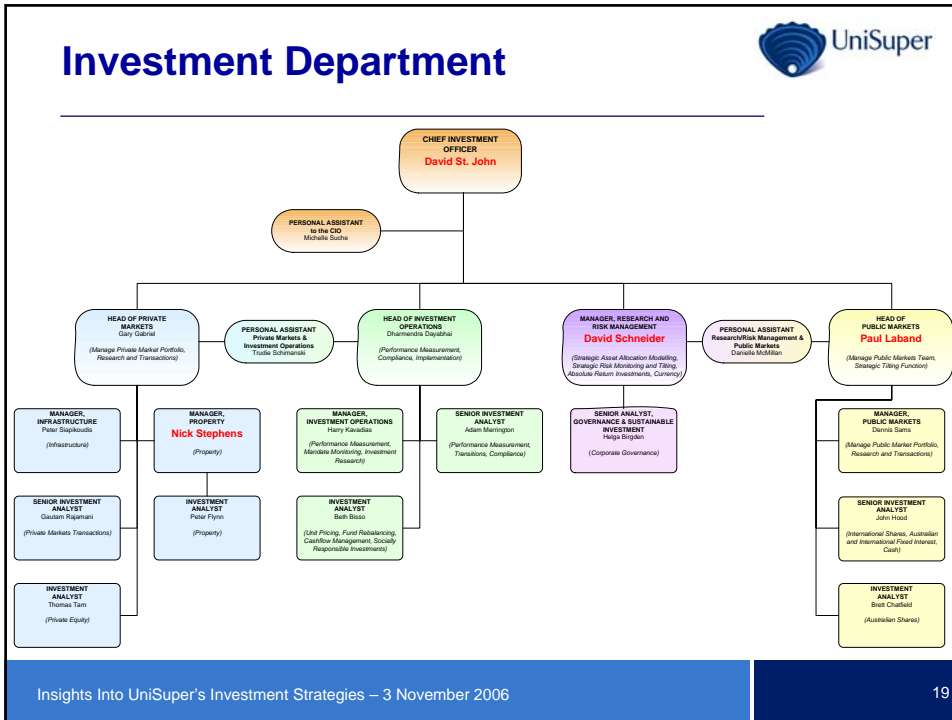
- › Elected not to invest in hedge funds
- › Incorporated innovative investment strategies (e.g. long/short strategies, strategic tilting)
- › Refined the Defined Benefit strategic asset allocation
- › Created new investment opportunities (e.g. emerging markets; small caps; microcaps; international private equity, international infrastructure and international property)
- › Building networks to increase proprietary dealflow and cut out intermediaries

## Broad Strategic Initiatives (cont'd)



- › Increased allocations to property (NB: \$388M in 2005/2006)
- › Opportunistically sold assets (e.g. Gorodok, 600 St. Kilda Road)
- › Increased manager diversification (i.e. listed property, domestic fixed interest, international fixed interest and cash)
- › Introducing five new investment options, including SRI Balanced Option on 1 July 2007
- › Streamlined decision making and operational processes

# Investment Department



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## Key Projects for 2006/07

## Key Projects 2006/07

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- › Research Projects
  - Increase internal strategic tilting capabilities
  - Merits of portable alpha
  - Use of synthetic products to aid in risk management (e.g. derivative strategies)
  - Develop position on sustainable investments
  
- › Australian shares
  - Appoint additional long/short managers

## Key Projects 2006/07 (cont'd)

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- › International shares
  - Increase allocation to high conviction and long/short managers
  - Appoint Asia Pacific ex-Japan managers
  
- › Property & Infrastructure
  - Appoint advisor for unlisted international property
  - Increase international exposures

## Key Projects 2006/07 (cont'd)



- › Private Equity
  - Develop and consolidate private equity program and relationships
  - Consider investment in emerging markets and distressed opportunities
- › Fixed Interest
  - New investment approaches (e.g. long/short)
- › Operations
  - Consider centralising listed securities trading activities



## The Pitfalls of Hedge Funds

David Schneider (*Manager, Research Risk Management*)

## Agenda

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- › What are hedge funds?
- › Phenomenal growth
- › Attractions
- › Pitfalls

## What are Hedge Funds?

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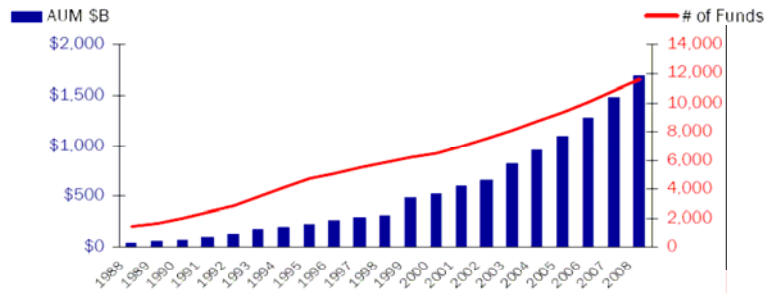


- › Hedge funds are unregulated investment vehicles
- › Characterised by:
  - Unconstrained choice of investments
  - Ability to move nimbly between opportunities
  - High fees
- › Include many broad categories (e.g. Global Macro, Arbitrage)

## Growth of Hedge Funds



- › Since the early 1990s, have grown exponentially
- › FUM: from \$50B to \$1.1 Trillion
- › Number of funds now exceed 8,000

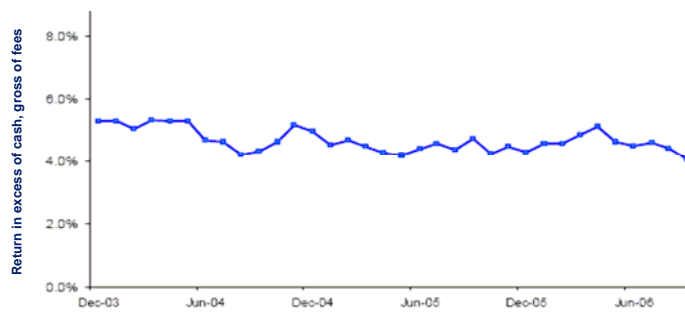


Source: Greenwich-Van Advisors, 2004

## Purported Advantages



- › Stable returns regardless of market conditions



Source: CSFB, 2006

- › Diversifier of returns
- › Talent has flocked to hedge funds

## Pitfalls



### 1. The Failure Rate of Hedge Funds

- Hedge funds shut down at an alarming rate (20% p.a.)
- Hedge funds carry operational risks
  - Lack of capital
  - Lack of management expertise
  - Few resources

## Pitfalls (cont'd)



### 2. Overstated Returns

- Biases in the historic returns
  1. Backfill (or incubation) bias ~5.8% pa
  2. Survivorship bias (between 0.6% and 4.4% p.a.)
- Variance of returns are under-stated:
  1. Marking to model
  2. Booking option/insurance premiums as profit
- Hence risk adjusted returns are significantly over-stated

## Pitfalls (cont'd)

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### 3. Lack of Transparency

- Hedge fund managers argue
  - Strategies/models are confidential
- Question whether institutional investors actually require information

## Pitfalls (cont'd)

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### 4. Lack of Liquidity

- Have long notice or 'lock up' periods (often quarterly)
- Have long settlement periods (eg 30 days)
- Use illiquid instruments
- Lack of liquidity is usually less important for long-term investors
  - Low hedge fund persistency raises concerns

## Pitfalls (cont'd)



### 5. Excessive Fees

- Typically: 2% + 20%
  - With a cash or 0% hurdle
  
- Arguments in favour
  - Skill-based
  - Alignment of interest
  
- 'Dressed up' market exposure, presented as skill?
- Appropriateness of the hurdle?

## Summary



- › Popular and have grown rapidly
  - › But serious concerns:
    1. High failure rate
    2. Returns are over-stated
    3. Lack of transparency
    4. Lack of liquidity
    5. Excessive fees
- Generally - not an attractive investment proposition**
- › UniSuper continues to monitor developments

# Long/Short Equity Strategies

Paul Laband (*Head of Public Markets*)

## Presentation Outline

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- › What is long/short investing?
- › UniSuper's Australian shares long/short results
- › The international shares long/short mandate

# What is Long/Short Equity Investing?



## › Long only portfolio

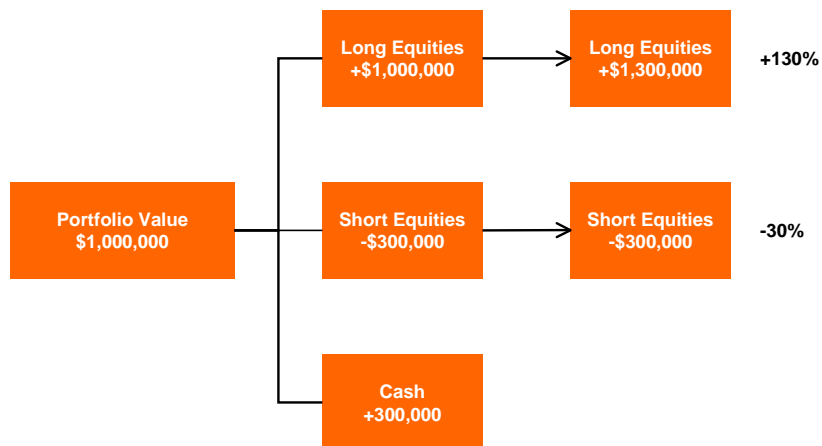


## › Long/Short portfolio



# Long/Short Investing

## 130/30 Structure



## Australian Shares

### Long/Short Results (as at 30 June 2006)



	Since Inception % p.a.
Australian long/short portfolio	23.6
S&P ASX 300 Index	22.8
Excess Return	0.8

## International Shares

### Long/Short



#### › Key Features

Type of Fund	130/30
Size of Investment	\$250M
Manager	SSgA
Process	Quantitative <ul style="list-style-type: none"> <li>➤ Value</li> <li>➤ Growth</li> <li>➤ Sentiment</li> <li>➤ Quality</li> </ul>
Number of Stocks	300
Target Excess Return	4 - 5% above MSCI World index
Risk Controls	Region neutral, global sector neutral

## International Shares Long/Short (cont'd)



### › SSgA 130/30 Fund – Risk Controls

– Region Neutral:

MSCI World Index		SSgA 130/30		
	%	Long	Short	Neutral
North America	60	65	5	60
Europe	30	40	10	30
Pacific	10	25	15	10
		<b>130</b>	<b>30</b>	<b>100</b>

– Sector Neutral:

MSCI World Index		SSgA 130/30		
	%	Long	Short	Neutral
Financials	25	30	5	25
Healthcare	10	20	10	10
I.T.	10	25	15	10

## Summary



- › What is long/short investing?
- › UniSuper's Australian shares long/short results
- › The international shares long/short mandate

# Property

Nick Stephens (*Manager, Property*)

## Introduction

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Three transactions completed over the last 12 months:

- › 600 St Kilda Road, Melbourne, VIC – Sale transaction
- › 50 Lonsdale Street, Melbourne, VIC – Development / long term hold
- › Dapto Mall, Dapto, NSW – Retail redevelopment

## 600 St. Kilda Road, Melbourne



- › Acquired 1999
- › Status of St Kilda Road office precinct has been in recent decline
- › No longer a strategic fit for the portfolio
- › Management maximized exit value
- › Sold 2006 at premium to book value
- › Reinvested in higher quality assets



## 50 Lonsdale Street, Melbourne



- › Acquired 2003
- › Development of 70,000 m<sup>2</sup> office tower
- › 80% pre let to the state govt
- › Realised 22% pa IRR vs. expected return of 17% p.a.
- › Investment rolled over
- › Targeting a 4.5 star energy efficiency rating



## Dapto Mall, Dapto, NSW



- › Acquired progressively since 1994
- › High growth residential corridor
- › Redevelopment to provide 23,000 m<sup>2</sup> shopping centre
- › Anchored by Woolworths, Big W and Coles
- › Mall to dominate its retail trade catchment
- › And provide a core growth asset for the portfolio



## Property Implementation Strategy



- › Innovative
- › Nimble / opportunistic
- › Value creators as well as being value investors

# Conclusions

## Conclusions

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- › UniSuper has established itself as a market leader
  - Fund continues to perform well
  - Disciplined (e.g. Hedge Funds)
  - Innovative (e.g. Long/short strategies)
  - Opportunistic/Nimble (e.g. Property deals)

- UniSuper continues to refine its investment arrangements
- UniSuper is focussed generating on competitive risk-adjusted returns

Questions?